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Central Intelligence Agency

Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

International Financial Situation Report #45
24 October 1985

Summary

The new US initiatives on LDC debt, announced at the IMF/IBRD meetings in Seoul, were welcomed by most members of the international financial community. We believe the successful implementation of these proposals will depend on several key developments due to unfold over the next few months, including: progress in Mexico's and Brazil's negotiations with the IMF, commercial bankers' willingness to raise the $20 billion in new money for the LDCs, the debtor's individual reactions to the modified debt strategy, and the collective response expected from the Cartagena Group, which will meet in mid-December. Other developments in recent week include: 25X1

- [redacted] Mexico may need about $9 billion in new money for 1986—substantially more than the $4.8 billion already requested. The new figure reflects a $2 billion financial gap carried over from 1985, higher-than-anticipated capital flight, and a likely drop in oil prices because of Saudi Arabia's decision to increase production. Mexico is scheduled to begin talks with the IMF in the next few weeks. 25X1

[redacted]

- While Yugoslav officials are optimistic about negotiating a MYRA with their official creditors, their prospects are being dimmed by a disappointing economic performance this year. Yugoslavia seems unlikely to meet their 1985 current account and reserve targets.

- Disbursements from the Philippines' standby program and the bank new money package continue to be delayed. According to Embassy reporting, Prime Minister Virata states that the budget deficit is the only major issue yet to be resolved. 25X1

- South Africa's major creditors doubt that a rescheduling accord can be reached before Pretoria's self-imposed moratorium deadline of 31 December. [redacted] 25X1

[redacted] 25X1

This situation report was prepared by analysts of the Intelligence Directorate. Comments are welcome and may be addressed to the Situation Report Coordinator, [redacted] 25X1
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UPCOMING IMPORTANT DATES

Date	Event/Country	Comment
23-30 October	Saudi Arabia Conference on Sudan	King Fahd has invited Arab and other creditor countries and institutions to a conference discussing the Sudanese economy and settlement of their debts to Arab banks and other creditors. 25X1
25 October	IMF Executive Board Meeting	Arrears owed to the Fund by Sudan will be considered. 25X1
28 October	Commercial Bank Meeting	The Institute for International Finance has invited about 60 executives from the world's largest banks to a meeting to discuss the new US initiatives on debt. 25X1
14-16 November	University of South Carolina Debt Conference	The University has invited Latin American and Caribbean countries and major creditors, including the IMF and World Bank, to a discussion of the debt issue. 25X1
18 November	Paris Club-Poland	Tentatively scheduled meeting to discuss rescheduling of debt owed to official bilateral creditors. 25X1
19 November	Paris Club-Cuba	Meeting to review Cuban economic performance under the June Paris Club agreement. 25X1
21 November	Paris Club-Central African Republic	Meeting to discuss rescheduling of debt owed to official bilateral creditors. 25X1
22 November	Paris Club-Niger	Meeting to discuss rescheduling of debt owed to official bilateral creditors. 25X1
Week of 16 December	Cartagena Group Ministerial Meeting (Montevideo)	Tentatively scheduled meeting of the Cartagena Group foreign and economic ministers. 25X1

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[redacted]

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KEY ISSUE

US Initiatives on Debt: Key Developments to Watch

The new US initiatives on LDC debt, announced publicly at the IMF/IBRD annual meetings in Seoul, were welcomed by most members of the international financial community [redacted] They applauded the more active US leadership role, the new emphasis on LDC economic growth, and the increased role for the World Bank. [redacted]

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We believe the successful implementation of the US initiatives will depend upon the following key developments, which will begin to unfold during the next few months:

- The nature and outcome of Mexico's and Brazil's negotiations for future assistance from the IMF.

- Commercial bankers' willingness to lend the proposed $20 billion in new money to 15 LDCs over the next three years.

- The debtors' reaction to and willingness to accept the types of policy reforms proposed by Secretary Baker. [redacted]

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Brazil and Mexico—the two largest LDC debtors—will start new program negotiations with the Fund in the next month. If agreements cannot be reached, we believe Mexico or Brazil could seek an accommodation with the World Bank, but this would still require substantial adjustment. We believe any new stabilization programs are likely to reflect more of the growth-oriented policies encouraged by the US initiatives. Secretary Baker is urging the IMF to give a high priority to structural adjustment measures such as tax reform and market-oriented pricing policies. It is questionable, in our judgment, whether or not the new money available through the new US initiatives will be enough of a "carrot" to entice Brazil and Mexico to implement substantial economic reforms. Countries like Argentina and Chile may be more likely to undertake the type of structural adjustment that is being encouraged in the US proposals. [redacted]

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While guardedly optimistic about the initiatives, commercial bankers complain that the only substantive portion of proposal is the call for banks to provide the debt-troubled LDCs with $20 billion in new money. [redacted] 25X1 commercial bankers now want a stronger voice in determining where the new money goes; in particular, they want to be able to direct the funds to their own customers in LDCs. They also are seeking concessions from the US Treasury and banking regulators, according to press reporting. [redacted]

25X1

The extent of commercial bank participation in the new money facility bears particular watching. The larger US banks probably will participate to ensure that their outstanding commitments continue to be serviced. We believe, however, that smaller US regional banks and European banks may find it easy to walk away from talk of new money. [redacted] 25X1

25X1 [redacted] Strong signals on commercial bankers' attitudes are likely

[redacted]

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[redacted]

to arise later this month when 60 major international bankers are scheduled to meet in Washington to discuss their role in future debt negotiations. [redacted] 25X1

From the debtor side, Latin officials in Argentina, Brazil, and Mexico view the US proposal as an important gesture, a sign that the US recognizes the LDC need to restore economic growth and obtain additional foreign capital. Considerable Latin skepticism exists, however, about the initiatives' potential to ease the region's financial burden. [redacted] 25X1 25X1 Buenos Aires questions the value of the initiatives if interest rates rise or commodity prices fall further, according to the US Embassy. We expect that a collective response to the US initiatives will come out of the Cartagena ministerial meeting scheduled for mid-December. [redacted] 25X1

REGIONAL SITUATIONS

Latin America

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In Latin America, [redacted] Argentina may devalue its currency following the 3 November election. [redacted]

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[redacted]

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[redacted] 25X1

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Argentina

As a result of President Alfonsin's stabilization program, Argentina's inflation rate was held to 2.0 percent last month, and Congress passed a 1985 budget containing the lowest deficit in ten years. Moreover, the first $2.2 billion tranche from the $4.2 billion new money facility was received from commercial bankers. Government officials have told the US Embassy that the wage and price freeze will continue through the end of the year. According to the US Embassy, some Argentines believe there could be a devaluation of the official exchange rate shortly after the 3 November elections, which should enable Argentina to maintain its competitiveness in world markets. Nevertheless, we believe that political pressures will cause Alfonsin to expand public spending within a few months.

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Panama

Panama's commercial bank creditors have tentatively set 31 October as the signing date for the 1985-86, $600 million refinancing package and the $60 million new money loan. However, the ouster of President Barletta has further weakened Panama's resolve to continue fiscal discipline. Although President Delvalle retained key members of Barletta's economic team to demonstrate continuity and calm international financial circles, Delvalle's recent populist economic stance probably has had a negative effect. Delvalle last week boosted price subsidies on some consumer staples, and indicated a disinclination to adopt economic reforms sought by the World Bank and by the US, according to Embassy reports. If reforms are not adopted in a timely fashion, disbursements from the IBRD, the US government, and commercial banks that are needed to fill the financial gap may be in jeopardy.

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Eastern Europe

In Eastern Europe, Yugoslavia's prospects for a MYRA are dimmed by poor economic performance, and Poland's bilateral rescheduling agreements are proceeding slowly.

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Yugoslavia

Yugoslav officials attending the IMF annual meeting in Seoul were reportedly optimistic about persuading their official creditors to grant a multiyear rescheduling of some $1.5 billion in debt falling due in 1986-88, according to press reports. Their optimism is based on Yugoslavia's successful conclusion of a MYRA with commercial banks in mid-September, which they believe will encourage official creditors to grant a

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[redacted]

similar arrangement. Finance Secretary Klemencic and other officials continue to stress Yugoslavia's need for a longer-term arrangement in order to free key Yugoslav economic decision makers for work on economic reform measures. [redacted] 25X1

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Prospects for a MYRA from official creditors, however, are being dimmed by disappointing economic performance in 1985. Earlier this year, official creditors refused Belgrade's request for a MYRA on grounds that Yugoslavia had made insufficient progress with economic adjustment, but promised to reconsider the request in 1986 if Yugoslavia's economy showed further improvement. Instead, Yugoslavia seems unlikely to meet their current account and reserve targets for 1985. Also worrisome is Belgrade's return on 1 October to extensive price controls. The IMF strongly objected to a similar set of measures announced in May 1984, which Belgrade subsequently lifted on 1 January 1985. Although the expanded price controls do not violate Yugoslavia's current Fund program, they do violate the spirit of the agreement, and official creditors may see the measures as backsliding on Yugoslavia's commitment to economic reform. Yugoslavia has also reduced interest rates by 9 percent, making real rates even more negative. [redacted] 25X1

25X1 [redacted]

Poland

Conclusion of the 1982-84 bilateral rescheduling agreements with Western governments is progressing slowly.

- According to Embassy reporting, France in late September became the second country to sign a bilateral with the Poles, but the agreement made no mention of the $10 million in new credits that Paris previously indicated it would grant.

- Press reports indicate that West Germany initialed an agreement with Poland in mid-October, but details are not yet available.

- Finland initialed an agreement in July, and Sweden initialed an agreement on 10 October. According to US Embassy reporting, Sweden is considering reopening a line of credit dating back to 1981 with a current balance of $4-4.5 million.

Negotiations with other Paris Club governments—including the United States—are being hampered by disputes over interest rates and new credit commitments. [redacted] 25X1

The US in late September received payment covering most of the 1981 interest arrears due by 31 August. France and several other countries also had received some payments. Because the payment was $1.5 million in arrears, however, the US has asked the Paris Club to postpone the next meeting from the week of 28 October to 18 November. [redacted] 25X1

[redacted] 25X1

 25X1

[redacted]

Asia

Philippines

The third drawing on the Philippines' IMF program continues to be delayed and lacking IMF approval, a $400 million disbursement from the commercial banks' new money package has been held up as well. [redacted] 25X1 25X1 25X1 While an agreement was not reached in Seoul, Virata has indicated that the budget deficit is the only major issue yet to be resolved, according to Embassy reporting. [redacted] 25X1 25X1 The Philippines' 1985 budget deficit is likely to be 2.5 percent of GNP instead of the targeted 0.9 percent. According to Philippine press reporting, the Philippines has asked the Fund to consider increasing the target to 1.4 percent of GNP. Virata believes the Fund will now agree to the larger budget deficit target, according to Embassy reporting. [redacted] 25X1

In another issue, the planned merger of the Philippine National Bank (PNB) and the Development Bank of the Philippines (DBP) is being complicated by the rescheduling of their foreign debts. According to press reports, commercial bankers expect numerous problems to develop if the reschedulings take place before the merger is concluded as is currently planned. The Philippine government is under a deadline to forge a rescheduling of 50 percent of the public-sector debt by the end of November. [redacted] 25X1 Commercial bankers want to wait for the final details of the merger before signing any rescheduling agreements. 25X1 [redacted]

Africa/Middle East

South Africa

25X1 The first meeting between South Africa's debt mediator, Fritz Leutwiler, and the country's commercial bank creditors occurred in London this week [redacted] 25X1 Major creditors doubt a rescheduling accord can be reached, however, before Pretoria's self-imposed moratorium deadline of 31 December, [redacted] 25X1 25X1 25X1

The negotiation process will be a fragile one, and an extension of the moratorium would provide added opportunity for events on either side to disrupt talks. A dramatic increase in violence in South Africa or expansion of repressive government measures might cause bankers to balk. [redacted] 25X1 25X1

[redacted] 25X1

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FINANCIAL BRIEFS

Americas

- The **Cartagena Group** has tentatively scheduled a ministerial meeting for Montevideo in mid-December...will respond to the new US initiatives... also focus on a political dialogue, trade issues, and the capitalization of interest payments. [redacted] 25X1

- **Cuba**'s commercial bank creditors rescheduled about $100 million in principal due in 1985...repayment spread over 10 years, 6 years grace at 1.5 percentage points above LIBOR...agreement also rolls over some $370 million in short-term loans for one year. [redacted] 25X1

- New **Panamanian** President Delvalle willing to host Latin American summit on debt, according to US Embassy...former President Barletta had agreed to host meeting at request of Peruvian President Garcia...Delvalle considering convening summit in early 1986. [redacted] 25X1

25X1 [redacted]

- Political pressures recently forced President Lusinchi to demand a contingency clause in **Venezuela**'s restructuring that would allow a renegotiation in the event of a sharp decline in future oil prices...signing of the $21.2 billion deal not expected until December at the earliest. [redacted] 25X1

Europe

- **Bulgaria** negotiating a $125-million club loan led by West Germany's Deutsche Bank...third loan since June, raises Sofia's borrowing to $450 million for 1985...needed to finance imports of Western capital goods and agricultural products. [redacted] 25X1

- **France**'s President Mitterrand visited several Latin nations...announced France is willing to promote a summit to discuss debt, according to press reporting...however, he noted that a meeting at that level must be "successful." [redacted] 25X1

[redacted] 25X1

25X1

25X1

- A 5-year, $167 million syndication is being raised for **Romania**...needed to meet rescheduled obligations coming due this fall [redacted]

25X1

- IMF team in **Turkey** is generally upbeat about the economy which strengthened after weak first quarter...fiscal and monetary policies still off-target... team thinks Ozal was premature in announcing there would be no program in 1986. [redacted] 25X1

Asia

- **North Korea** unable to make debt payment of $9 million to Indonesia... continues to have trouble making its payments to Western Europe and Japan... Koreans suggest resolution by countertrade or a two to three year payment postponement. [redacted] 25X1

- Bankers' confidence in **South Korea** continues as $300 million loan to Korean Export-Import Bank was signed in Paris...some concern voiced about overall debt level, and limited options available to Korea to deal with economic difficulty. [redacted] 25X1

25X1

- [redacted] Taiwan aspires to be an international financial center, has not yet adopted sufficient banking standards to facilitate such development. [redacted] 25X1

25X1

Africa/Middle East

- Western banks reduced **Nigerian** trade financing as letter of credit arrears rose by $1 billion in the past few months...$116 million in promissory notes released bringing total to $925 million out of estimated $6 billion in uninsured trade arrears...public opinion strongly against IMF accord. [redacted] 25X1

- IMF is not optimistic about payment of **Zambia**'s arrears...new program not expected before April 1986, by then arrears would be over $160 million... situation may become "irresolvable" without change in IMF policy, according to US Embassy. [redacted] 25X1

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